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UNCLAS SECTION 01 OF 02 STOCKHOLM 000631

SENSITIVE BUT UNCLASSIFIED

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SUBJECT: SWEDISH GOVERNMENT PUBLICALLY PRESSURES LATVIAN GOVERNMENT

STOCKHOLM 00000631 001.2 OF 002

¶1. (U) Summary: Swedish officials publicly chastised the Government of Latvia for its inability to present a 2010 budget that would satisfy IMF and EU conditions during the annual IMF meeting this weekend. Swedish Prime Minister Fredrik Reinfeldt and Finance Minister Andres Borg warned Riga that next disbursements of the aid to rescue the Latvian economy will be jeopardized if Latvian authorities fail to follow through on promises made to lenders. Latvian Prime Minister Valdis Dombrovskis called the comments unhelpful while Swedish banks reiterated their commitment to stay the course in Latvia. End Summary.

¶2. (U) The Latvian government in July renegotiated the original terms of the \$10.5 billion rescue package agreed upon on in December 2008 and committed to reduce the 2010 budget deficit to 10 percent by cutting spending by \$1 billion in 2010 to secure the second tranche of the aid package, to which Sweden is third largest contributor after the EU and the IMF. Prime Minister Dombrovskis on 20 September, however, presented a 2010 budget outline that effectively acknowledged that the government will not comply with its IMF and EU commitments.

¶3. (U) Swedish Finance Minister Anders Borg increased the pressure on the Latvian government by stating publicly that it will be very difficult to secure the continued support of other lenders "if the Latvians don't even live up to what they promised." "You can simply not behave like this," Borg said. Swedish Prime Minister Fredrik Reinfeldt echoed Borg's comments and expressed publically his displeasure with the Latvian government's lack of commitment to follow through. "If you make a deal to get a hold on the Latvian economy, then the Latvian Government has to make sure to do its part of the bargain," Reinfeldt said and at the same time warned that "the cuts are preconditions for (Sweden) to make the payments and that "the IMF will also have issues with this."

¶4. (U) The Latvian Prime Minister Valdis Dombrovskis responded by calling these comments "unhelpful" and added that the Latvian government is trying to avoid saving for the sake of saving alone. "I have heard no credible economic analysis behind the comments by Borg," Dombrovskis said. Despite the concerns, Dombrovskis reiterated that Riga will meet the deficit goal (of no more than 10 percent of GDP in 2010 and 8.5 percent the following year) despite smaller cuts and questioned the economic reasons that would justify Borg's comments. He expressed his disillusionment by adding: "I have held negotiations with the IMF and the European Commission and they have not even been close to show the same level of aggressiveness as Borg."

Swedish banks not concerned, prepared for all possible outcomes

¶5. (U) Despite the concern expressed by Reinfeldt and Borg, major Nordic banks have not publically echoed the Swedish government's concerns. "There are now ongoing negotiations on the third part of the IMF support-package and these recent statements should be viewed

in the light of that," said Thomas Backteman, Director of Communications at Swedbank. Backteman noted that "we have continuous contacts with Swedish authorities and politicians." Backteman emphasized that "(Swedbank's) strategy is to be prepared for all possible outcomes and that "no EU member will be allowed to cancel its payments." "Latvia has not had reason to change over the last couple of days," according to Backteman." Vivika Hirdman-Ryrberg, Head of Communications at SEB, mirrored Backteman's comments and emphasized publically the Swedish banks' joint declaration in September to continue its long-term commitments in the region. Similarly, Nordea's Helena Vsterman, Chief Press Officer, said that there appears to be no reason for concern and that "there are no reasons for changing (Nordea's) strategy in the Baltic region. For us there are no greater reasons for concern now than it was earlier."

¶6. (U) In contrast, the Stockholm Business Daily Newspaper Dagens Industri reported that the situation is far worse than it seems. Alf Vanags, Director at the Baltic International Centre for Economic Policy Studies, commented that "Anders Borg's and the IMF's views [on the current situation] are far worse than they want to admit publicly. The current situation in Latvia is that the government is not capable of agreeing on anything." He added that "(he) has long believed that the way out of this situation, and it would be a good way, would be to change the exchange rate. That would give the government authorities room to act."

¶7. (SBU) Comment: We think this sudden public breach is more a signal to the Latvian government than a sign of Swedish plans to withdrawal of support for Latvia's current economic stabilization program. Swedish Finance Ministry officials, and Swedish bankers, have repeatedly told us of their close cooperation with Latvian counterparts. The banks have assured us they intend to stay in Latvia for the long haul to expand their market share, and that they

STOCKHOLM 00000631 002.2 OF 002

view the Baltics as their home market. The criticism consistently voiced to us by Finance Minister Borg, and his State Secretaries Per Jansson and Matts Odell is that because of the "political philosophy" of the "neoconservative" Latvian government they are choosing the painful course of an international devaluation rather than adjusting their currency, and they are attempting the entire adjustment through severe budget cuts rather than tax increases. Since July, Swedish officials have questioned whether Latvia's plans were sustainable, with Finance Minister Borg telling us the chance of a devaluation by year-end were 50-50.

¶8. (SBU) Comment: A lats devaluation would result in accelerated, but manageable, loan losses for those Swedish banks with significant exposure to Latvia. The risks the Latvian economy poses to Swedish banks became evident shortly after Borg and Reinfeldt's comments during the October 5 trading session as SEB and Swedbank stocks fell by 4 and 2 percent, respectively. Post will follow up with our contacts and report more via septel. End comment.

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